

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact [REDACTED]

Telephone Number [REDACTED]

Refer Reply to: CP:E:EO:T:1-JC

Date: OCT 26 1995

Employer Identification Number: [REDACTED]
Key District: Northeast (Brooklyn)

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

FACTS

You were formed on [REDACTED], under the Stock Corporation Act of the State of [REDACTED]. As provided in Section 2 of your Articles of Incorporation you were formed for the specific purpose of rendering professional medical services to persons in need of such services and to do so under the common control and direction of [REDACTED] (the "Hospital"). This section also provides that you "shall not conduct or carry on any activities not permitted to be conducted or carried on, nor make any grant not permitted to be made, by an organization exempt under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986, as amended."

Section 3(C)(ii) of your Articles of Incorporation provides that "no part of the net earnings of the Corporation shall inure to the benefit of or be distributed to any shareholder of the Corporation, or to the Corporation's directors or officers, or to any private persons. . . . To the extent that the Corporation has net earnings in excess of the Corporation's needs as determined by the Board of Directors of the Corporation, then such excess net earnings may, by action of the Board of Directors of the Corporation, be distributed to the Hospital and/or one or more of its tax-exempt affiliates. . . . Upon dissolution of the Corporation, the Directors first shall pay or make provision for the payment of all the liabilities of the Corporation, and then shall transfer all of the remaining assets of the Corporation to the Hospital, or one or more of its tax-exempt affiliates of the Hospital. . . ."

Section 3(B) of your Articles of Incorporation provides that "only those persons who are licensed to practice medicine in the State of [REDACTED] and who have entered into a contractual agreement with the Hospital and the Corporation with respect to the ownership of shares of stock of the Corporation shall be eligible to be shareholders of the Corporation." The agreement with your only stockholder provides that the stockholder delivers the stock to the Hospital and grants the Hospital a power of attorney to transfer the shares on his behalf. You have one stockholder, a physician. An agreement with the Hospital, on whose behalf the stockholder holds the stock, limits his ability to control you.

Section 4 of your Articles of Incorporation requires that "at least a majority of the members of the Board of Directors shall be persons who are employees or directors of the Hospital or a tax-exempt affiliate of the Hospital." Section 2 of Article II of your Bylaws provides that Directors will be elected by the shareholders. A two member Board of Directors governs you. All directors are physicians.

You provide primary health care to members of the general public. You also carry on educational activities on medical or health related subjects open to the general public. You provide medical care to those unable to pay. You also provide nondiscriminatory treatment to Medicare beneficiaries and Medicaid recipients. Your principal source of support is fees for services.

ANALYSIS

You claim that you were formed as a Professional Service Corporation and not as a nonstock corporation because of the existence in [REDACTED] of the "Corporate Practice of Medicine Doctrine." Although there is no case law or statute that specifically forbids corporations from hiring physicians to treat patients, you believe that the "Corporate Practice of Medicine Doctrine" exists in [REDACTED].

The only Opinion of the Attorney General of [REDACTED] on this issue was published in [REDACTED] Opin. Atty. Gen. [REDACTED]. In that case the issue was the hiring of physicians by general charitable hospitals. Physicians were paid a salary and the hospitals charged the patients for their services. The services provided by the physicians were such as radiology, anesthesiology, and pathology. In his opinion the Attorney General exempted charitable hospitals from restrictions on the employment of physicians.

The Attorney General determined that "though not expressly in the statute, the implication is clear that the practice of medicine and surgery is restricted to individuals and does not include corporations." Nevertheless, he also determined that this did not include non-profit charitable hospitals and that the restrictions were directed toward commercial corporations that were run for a profit. The Attorney General believed that his opinion was strengthened by the Dental Practice Act that provided that no corporation could own or operate a dental office but exempted hospitals from such restriction.

The Attorney General reasoned that clearly if a hospital can own or operate a dental office, it can own a clinic to provide health care that is more in line with a hospital's mission than the provision of dental care.

Section 501(a) of the Internal Revenue Code exempts from taxation organizations described in subsection (c)(3), which includes corporations organized and operated exclusively for charitable and educational purposes. Furthermore the aforementioned subsection requires that no part of the organization's net earnings inure to the benefit of any private shareholder or individual, that no substantial part of its activities is to influence legislation, and that it does not participate in any political campaign on behalf or in opposition to any candidate for public office.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that to be exempt as an organization described in section 501(c)(3) of the Code an organization must be both organized and operated exclusively for purposes specified in said section of the Code. If an organization fails to meet either test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i)(a) of the regulations provides that an organization's articles of organization must limit its purposes to one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities that are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iv) of the regulations provides that in no case shall an organization be considered organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created

are broader than the purposes specified in section 501(c)(3) of the Code. The fact that the actual operations of such an organization have been exclusively in furtherance of one or more exempt purposes shall not be sufficient to permit the organization to meet the organizational test. Further, the organizational test is not satisfied by statements or other evidence that the members of the organization intend to operate only in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(5) of the regulations provides that the law of the State in which an organization is created shall be controlling in construing the terms of its articles. However, any organization which contends that such terms have under State law a different meaning from their generally accepted meaning must establish such special meaning by clear and convincing reference to relevant court decisions, opinions of the State attorney-general, or other evidence of applicable law.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that in order for an organization to be considered operated for one or more exempt purposes, it must engage primarily in activities that accomplish one or more exempt purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated for an exempt purpose unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" as used in section 501(c)(3) of the Code includes its generally accepted legal sense. The promotion of health is a recognized charitable purpose. Rev. Rul. 56-185, 1956-1 C.B. 202, as modified by Rev. Rul. 69-545, 1969-2 C.B. 117; Rev. Rul. 80-114, 1980-1 C.B. 115; and Rev. Rul. 83-157, 1983-2 C.B. 94.

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that the following factors indicate that the use and control of a hospital are for the benefit of the public and that no part of the income of the organization is inuring to the benefit of any private individual nor is any private interest being served:

1. It is controlled by a board of trustees, which is composed of independent civic leaders.
2. It maintains an open medical staff with privileges available to all qualified physicians including leasing available space in its medical building.

3. It operates an active and generally accessible emergency room.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. This case is the basis of section 1.501(c)(3)-1(c)(1) of the regulations, which provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

As established in Rev. Rul. 69-545, supra, the fact that a medical organization is controlled by a board of trustees composed of independent civic leaders is an indication that the use and control of the organization is for the benefit of the public. You were formed as a professional corporation under the laws of [REDACTED]. Your stock is owned by a physician and all members of your Board must be physicians. You have represented that the "Corporate Practice of Medicine Doctrine" in [REDACTED] precludes nonprofit corporations from employing physicians to provide medical care. In the 1954 Attorney General opinion, supra, it was made clear that such restrictions were not applicable to non-profit charitable hospitals. Furthermore, the opinion clearly stated that the restrictions were directed toward commercial corporations that were run for a profit.

You are organized as a commercial for-profit corporation. The inclusion in your Articles of Incorporation of language to meet section 501(c)(3) standards does not alter your classification as a for-profit professional corporation in a state in which a nonprofit corporation can employ physicians to provide medical care. As a professional corporation, you fail the organizational test under section 501(c)(3) of the Code because you have the substantial nonexempt commercial purpose of rendering professional medical services. Since you are organized and operated as a professional corporation with substantial nonexempt purposes, you are not organized and operated exclusively for exempt purposes. Therefore, you do not meet the requirements of the organizational and operational tests under section 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption from federal income tax under 501(c)(3) of the Internal Revenue Code. Contributions to you are not deductible under section 170 of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under the Conference and Practice Requirements.

Your protest should be submitted to the following address:

CP:E:EO:T:1-JC, Room 6514
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Brooklyn, New York, which is your key district for exempt organization matters. Thereafter, any questions about your federal tax status or the filing of returns should be addressed to that office. If you want the matter reopened at a later time, you must pay a new user fee as provided in Rev. Proc. 95-8, 1995-1 I.R.B. 187. Also, the appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

(Signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Technical Branch 1

cc:



cc



State Authorities

	: Initiator	: Reviewer	: Reviewer	: Reviewer
Code	: CP:E:EO:T:1-JC:CP:E:EO:T:1	:	:	:
Surname	: [Redacted]	:	:	:
Date	: 10-25-95	:	:	:

10/26/95